OFFICE OF THE CITY AUDITOR

FOLLOW-UP AUDIT OF THE AVIATION LEASE AND RENTAL AGREEMENTS AND OTHER FINANCIAL ISSUES

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June 30, 2006

Memorandum

CITY OF DALLAS

June 30, 2006

Honorable Mayor and Members of the City Council
City of Dallas

We have conducted this audit under the authority of Chapter IX of the City Charter and according to applicable government auditing standards. We conducted tests of records and reviews of program guidelines and procedures that we considered necessary in the circumstances.

Our objectives were to:

- Review other financial issues pertaining to the Aviation Department
- Determine whether the Aviation Department has:
  - Increased rates and fees;
  - Implemented the audit's recommendations identified in the original audit report; and
  - Implemented the Real Estate Task Force recommendations.

During our audit we noted concerns relating to rates and fees and financial issues. These concerns are addressed in the Opportunities for Improvement section of this report.

The original audit report contained three findings with five recommendations. The following is a summary of the status of the recommendations: one – implemented, three – partially implemented, one – not implemented.

The Real Estate Task Force Report contained 39 recommendations. Except for one recommendation which has not been implemented, Aviation has implemented all other recommendations.

We appreciate the cooperation of City staff during our examination.

Paul T. Garner
Paul T. Garner
Assistant City Auditor

c: Mary K. Suhm, City Manager

FOLLOW-UP AUDIT OF THE AVIATION LEASE AND RENTAL AGREEMENTS AND OTHER FINANCIAL ISSUES

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EXECUTIVE SUMMARY

We conducted a review of financial issues pertaining to the Aviation Department. We also performed a follow-up on the Audit of Aviation Lease and Rental Agreements, dated January 14, 2005, and included a follow-up on the Real Estate Task Force recommendations.

Our scope was (a) financial and accounting issues subsequent to our 2005 audit, (b) the recommendations included in the January 2005 audit, and (c) the recommendations from the Mayor's Real Estate Task Force.

Our audit objectives were to determine:

- The status of the following financial issues;
    - Classification of restricted versus unrestricted assets for current and prior periods;
    - Incorrect revenue amounts reported for prior periods;
    - Whether the bond ratings were properly disclosed; and
    - Aviation Department's loan to the General Fund.
- Whether the Aviation Department has:
    - Increased rates and fees;
    - Implemented the audit's recommendations identified in the original audit report; and
    - Implemented the Real Estate Task Force recommendations.

Our audit determined the following:

- Regarding the classification of restricted and unrestricted assets for the fiscal years 2003 and 2004 it was determined that upon completion of the parking garage, the bond ordinance did not require a restriction of assets. Therefore, there is no requirement to report restricted assets in fiscal years 2004 and 2005.

- Disclosure and reporting of financial and accounting issues were not properly presented.
    - Downgrade of bond ratings were not disclosed and bond ratings reported were inaccurate;
    - Financial data was not properly presented;
    - Loan from Aviation Department is still outstanding and has not been approved by the City Council; and
    - There are no policies and procedures for the funding and use of reserve/contingency fund.

- Landing fees were not increased in a timely manner and new proposed fees have not been implemented.

- The original audit report of January 14, 2005, contained three findings with five recommendations. Management implemented one of the recommendations, partially implemented three, and did not implement one.

- The Real Estate Task Force recommendation relating to the development of a policy to ensure annual reporting to the Council on month-to-month leases has not been implemented. All remaining 38 recommendations have been implemented.

The issues identified during the follow-up audit that need management consideration are addressed in the Opportunities for Improvement section of this report.

INTRODUCTION

AUTHORIZATION

We conducted a follow-up on the Audit of Aviation Lease and Rental Agreements, dated January 14, 2005, and included a follow-up on the Real Estate Task Force recommendations and a review of financial issues. This follow-up was conducted under the authority of Chapter IX of the Dallas Charter.

SCOPE AND METHODOLOGY

Our follow-up was conducted in accordance with generally accepted government auditing standards and, accordingly, included inquiries, tests of the accounting and related records, and other procedures that we considered necessary. Our scope was (a) financial and accounting issues subsequent to our 2005 audit, (b) the January 2005 audit, and (c) the recommendations from the Mayor's Real Estate Task Force.

Our audit objectives were to determine:

- The status of the following financial issues;
    - Classification of restricted versus unrestricted assets for current and prior periods;
    - Incorrect revenue amounts reported for prior periods;
    - Whether the bond ratings were properly disclosed; and
    - Aviation Department's loan to the General Fund.
- Whether the Aviation Department has:
    - Increased rates and fees;
    - Implemented the audit's recommendations identified in the original audit report; and
    - Implemented the Real Estate Task Force recommendations.

To develop an understanding of the Aviation Department's leasing financing and accounting practices and procedures, we:

- Reviewed City Code, Chapter 5 – Aircraft and Airports;
- Reviewed Federal Aviation Administration (FAA) *Policy Regarding Airport Rates and Charges* and FAA grant assurances applicable to recipients of federal funds;
- Interviewed Aviation Department staff and reviewed department's policies and procedures for the management of public property; and
- Examined records, supporting documents, and related transactions.

OVERALL CONCLUSION

Landing fees were not increased in a timely manner and new proposed fees have not been implemented.

With regards to the classification of restricted and unrestricted assets for the fiscal years 2003 and 2004, it was determined that upon completion of the parking garage, the bond ordinance did not require a restriction of assets. Therefore, there is no requirement to report restricted assets in fiscal years 2004 and 2005.

INTRODUCTION

Disclosure and reporting of financial and accounting issues were not properly presented.

The original audit report dated January 14, 2005, contained three findings with five recommendations. Management implemented one of the recommendations, partially implemented three, and did not implement one.

The Real Estate Task Force recommendation relating to the development of a policy to ensure annual reporting to the Council on month-to-month leases has not been implemented. All remaining 38 recommendations have been implemented.

The issues identified during the follow-up audit that need management consideration are addressed in the Opportunities for Improvement section of this report.

BACKGROUND

The City of Dallas owns and operates the Dallas Love Field Airport, Dallas Executive Airport (formerly Redbird Airport), and a heliport. These facilities are operated and managed by the City's Aviation Department, which is designated as an enterprise fund. An enterprise fund has operations that are financed and operated in a manner similar to private business enterprises – where the intent is that the costs of providing goods or services to the public on a continuing basis are financed or recovered primarily through user charges.

Dallas Love Field generates virtually all of the Aviation Department's revenues and is classified as a "compensatory" airport by the FAA. Under this classification, an airport proprietor assumes all liability for airports costs and retains all airport revenues for its administration in accordance with federal requirements. *FAA Policy Regarding Airport Rates and Charges* states that airport proprietors must maintain a fee and rental structure that, in the circumstances of an airport, **makes the airport as financially self-sustaining** (emphasis added) as possible. This is also reiterated in the FAA grant assurances for federal fund recipients.

All rental rates and fees, not established by the City Council, are determined by the Aviation Department. Therefore, the Aviation Department sets rates for (a) terminal space, (b) office space, (c) floor space, (d) canopy space (for rental car agencies), (e) hangar space, and (f) rates for short-term leases.

In April 2001, the Aviation Department issued $59.385 million in Series 2001 Airport System Revenue Bonds for construction of a 4,000 space parking garage. Construction of the new garage began in August of 2001 and was completed in April 2003.

The City's Financial Management Performance Criteria, which is included in the appendices of the adopted budgets, states that each enterprise fund of the City will maintain revenues that support the full (direct and indirect) cost of the utility.

INTRODUCTION

Additionally, Aviation's bond ordinance requires that total rentals, rates, fees, and charges produce sufficient annual gross revenues that will:

- Pay the operating and maintenance expenses of the airport system; and
- Be able to pay 1.25 times the sum of both the principal and interest on outstanding parity obligations.

A Real Estate Task Force, appointed by the Mayor and Council, has studied and assessed the Aviation Department's real estate practices and issued their report, dated October 18, 2004. The Task Force stated that a significant item missing from current procedures was a mechanism for formal review of month-to-month leases that have been in place for an extended period.

OPPORTUNITIES FOR IMPROVEMENT

We identified certain policies, procedures, and practices that could be improved. Our follow-up was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the opportunities for improvement present in this report may not include all areas where improvements may be needed.

Section I - Airport Rates and Fees and Aviation Department's Financial and Accounting Disclosures

1. The Aviation Department did not increase landing fees in a timely manner and new proposed fees have not been implemented.

- Landing fees were increased (i.e. re-instated) five years after the basis for the incentive expired. Dallas Love Field first set a $0.55 landing fee in 1975. In 1987, the Council, per City Code Section 5-31, offered a fee structure to encourage airlines to operate quieter airlines**.** Fees for older, noisier aircraft remained at $0.55 per 1,000 pounds, while newer, quieter aircraft paid $0.35. By 2000, the Federal Aviation Administration required all aircraft be the quieter version. The Aviation Director should have requested the City Council to re-instate the $0.55 landing fee in 2001.

  In February 2006, the Council approved an increase from $0.35 cents to $0.55 cents per 1000 pounds for all commercial aircraft effective April 2006.

  The Aviation Director, in his January 9, 2006, briefing to the Council's Transportation and Environment Committee, proposed the re-instatement of the $0.55 landing fee. However, the $0.55 landing fee is less than the fees charged by comparable medium-sized airports. Additionally, since the $0.55 fee dates back to 1975, the fee alone may not be sufficient to fund expenses for current operations.

- The Aviation Department proposed an Off-Airport Concessions Fee and included estimated revenues of $300,000 in its FY 04-05 budget. Our follow-up revealed that this fee has not been implemented.

- The Aviation Department proposed a Commercial Vehicle Fee (CVF) and included estimated revenues of $225,000 in its FY 04-05 budget. The Aviation Director briefed the Council's Transportation and Telecommunications Committee on June 6, 2005, that the CVF would yield estimated revenues of approximately $256,000 and this estimated revenue was included in its FY 05-06 budget. We noted to the Aviation Director that the CVF did not include an increase in the taxicab loading fee of $0.50, which has been in effect since the 1980s. The Aviation Director stated that he was reluctant to increase the taxicab loading fee until after the CVF was in place. Our follow up revealed that neither this CVF fee nor the increase in the taxicab loading fee was implemented.

Rates and fees have not supported airport operations and this has resulted in operating deficits (see Exhibits 1 and 2, pages 18-19). These operating deficits have required the Aviation Department to use cash reserves to meet bond obligations and this practice may have been a factor in the downgrading of the airport's bond rating.

We recommend the Director of Aviation:

- Address and establish rates and fees to support airport operations in a timely manner;
- Minimize the use of cash reserves to subsidize airport operations;
- Pursue immediate implementation of the proposed fees and that the CVF includes an increase in the taxicab loading fee;
- Brief the City Council annually on the estimated revenues, operating expenses, capital projects to be undertaken, and the required rates and fees necessary to sustain airport operations; and
- Conduct a rate and fee study to determine the alternatives available to meet operational and capital financing requirements.

Management's Response:

- **Partially Agree**
  The audit report indicates the landing fee should have increased in 2001. The City Auditor's Office is making this observation (more than five years later) and has indicated it is without analysis or regard to the impact such a rate increase may have had on the City's Aviation operations.

  Airport landing fees were increased by the Dallas City Council on March 22, 2006 from $0.35 to $0.55.

  Prior to September 11, 2001 Aviation Management had considered landing fee increases during prior year budget discussions along with other airport fee increases but such increases could not be justified considering Aviation's comparison between revenues and expense. In FY 2000, actual revenues were $29,986,691 with total actual expenses of $26,829,622 which included a Capital transfer of $8,874,951 and still resulted in a surplus of $3,157,069.

  In 2001, the Aviation industry was profoundly impacted by the terrorist attacks of September 11, 2001. American Airlines immediately ceased flying out of Love Field on September 12, 2001. Southwest Airlines (SWAL) subsequently cut flights. Any increases to airline costs during that period were viewed by Aviation Management as a potential to prompt additional SWAL flight cuts and even greater revenue losses in concessions and parking. Consequently, in 2003, recommendations were made to stabilize revenue by increasing rates other than landing fees. The Aviation Department with the approval from City Council implemented rate increases in some of the larger revenue sources available such as fuel flow fees (75%), terminal rentals (77%), and parking (40%). The rate increases generated twice the amount of revenues that a 57% landing fee hike would have without adding further stress on an industry with low load factors.

In the first full year after the April 2003 rate increases (FY04), parking, fuel flow and rental revenues increased by $2,045,414 whereas a 57% increase in landing fees would have only generated $958,013. Moreover, the $958,013 estimate assumes no additional flights would be lost due to implementation of a 57% landing fee increase from $0.35 to $0.55.

- **Agree**
  The Aviation Department agrees it should minimize the use of cash reserves to subsidize airport operations. However, the Department cannot anticipate or predict a catastrophe such as the one that happened in September 11, 2001. Additionally, it cannot predict the outcome of the catastrophe or how long it will take to overcome the results of the catastrophe. This is something all airports and airlines around the country have had to manage.

  The Off Airport Concession Fees were not implemented following 9-11 due to the decrease in passenger traffic at the airport. Enplanements were still down by 12% from 2001 levels during FY 04/05. Management surveyed other airports across the country to identify industry standards for charging off airport parking companies a percentage of gross revenues. After looking at other airports it was determined that charging the Off Airport Parking Companies and Hotels Courtesy Vehicle Operators a percentage of gross revenue was not feasible due to concerns that the increase would further erode enplanements. The Aviation Department recommended a flat vehicle trip fee program (Commercial Vehicle Fees) to replace the Off Airport Parking Concession Fee program.

  In the future the Aviation Department does not intend or plan to use cash reserves to subsidize airport operations.

- **Agree**
  The Aviation Department initially briefed the City Council's Transportation and Telecommunications Committee in 2003 to discuss the Clean Vehicle Fleet Program which included implementing the Commercial Vehicle Fee Program for Dallas Love Field. The Aviation Department also briefed the Council's Transportation and Telecommunication Committee in June of

2005. The City has faced legal challenges and other obstacles which has caused a delay in implementing this Commercial Vehicle Fee Program.

The City Attorney's Office has undertaken considerable efforts in researching the law concerning energy-efficient vehicle requirements and in drafting an appropriate regulatory ordinance that, among other things: (1) encompasses the different classes of ground transportation vehicles at the airport; (2) coordinates the courtesy vehicle registration requirements with the existing city ordinances regulating taxicabs, limousines, shuttles and buses; and, (3) creates an appropriate enforcement and appeal process to handle violations of the proposed ordinance.

Today a draft ordinance has been developed and is currently in final stages of review. The Aviation Department and the City Attorney’s Office expect to have a final ordinance to City Council for approval by the end of the calendar year.

- **Agree**
  The Aviation Department will update the City Council annually, or as is required, on the estimated revenues, operating expenses, capital projects to be undertaken and the required rates and fees necessary to sustain the airport’s operation.

- **Agree (already in effect)**
  A rate and fee review to determine the alternatives available to meet operational and capital financing requirement is currently done annually by the Aviation Department. Since Aviation is an enterprise fund, this determination has to be performed to make recommendations for the next year even if the recommendation is maintain current rates due to economic reasons such as the one described above following September 11. Without this determination, the Aviation Department could not assure there would be enough funding for the following fiscal year.

  Also, please note that “Depreciation” is the major reason for the Net Losses from Operations for FY 2002, FY 2003 and FY 2004 as shown in the Statement. However, annual depreciation does not require a cash outflow. Depreciation is an accounting entry meant to match the cost of the asset over the life of the asset. 49% of the depreciation expense is attributed to depreciation on “contributed capital” for those facilities built or put in place by the tenant as a requirement of their contracts with Dallas Love Field and/or Dallas Executive Airport. After they are in place, Aviation must then recognize the depreciation expense for these assets even though these assets are built for the benefit of the tenants. (Another point that must be made with regard to this issue is the Aviation Department is not responsible for the maintenance or replacement of these capital improvements.)

2. Downgrade of bond rating was not disclosed and bond ratings reported were inaccurate.

In April 2001, the Aviation Department issued $59.385 million in Series 2001 Airport System Revenue Bonds for the construction of a 4,000 space parking garage. The bonds were downgraded in 2003 and 2004 by bond rating agencies. The bond ratings shown in the Management's Discussion and Analysis (MD&A) section of the Comprehensive Annual Financial Report (CAFR) for FY 2003 and FY 2004 were incorrect.

Fiscal Year End	Bond Rating as Reported in CAFR for Moody's Investors Service	Bond Rating per Moody's Investors Service	Bond Rating as Reported in CAFR for Standard & Poor's	Bond Rating per Standard & Poor's
9/30/03	Aaa	A1	AAA	A-
9/30/04	Aaa	Baa2	AAA	BBB

Statement No. 34 of the Governmental Accounting Standards Board (GASB 34) requires that the MD & A provide a description of significant capital asset and long-term debt activity during the year, including changes in credit ratings.

Moody's "Baa" rating is for bonds that are considered as medium grade obligations (i.e. they are neither highly protected nor poorly secured.) Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well. Standard & Poor's "BBB" rating exhibits adequate protection parameters; however, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

We recommend the Director of Aviation coordinate with the City's Chief Financial Officer and the City Controller to ensure year-end financial reporting reflects the correct bond ratings as assigned by the bond rating agencies and that any changes in credit ratings are disclosed in the Management Discussion and Analysis portion of the financial statements and to the external auditors in the management representation letter.

Management's Response:

Agee

The Chief Financial Officer will ensure that the MD&A reflects the required reporting information set forth by Governmental Accounting Standards Board (GASB) 34 regarding bond rating as assigned by the bond rating agencies and any changes in credit rating. All future Comprehensive Annual Financial Reports (CAFR) will disclose this information.

It is important to note that with the addition of insurance to the Aviation bond sale in FY 2001 the bonds are rated Aaa by Moody's Investment Services and AAA by Standard & Poor's. Additionally, the underlying ratings by Moody's and Standard & Poor's, Baa2 and BBB respectively, for the Aviation Bonds are classified as "investment grade" by the rating agencies.

3. Financial data should be properly represented.

The following financial issues were based on our review of adopted budgets and the (audited) Comprehensive Annual Financial Report (CAFR).

- Beginning fund balances in the proposed and adopted budgets are not based on actual audited ending balances from the prior year.

  Our follow-up revealed that the beginning fund balances are not based on the CAFR, but are derived amounts based on the 13th period close and adjustments made to the prior year's adopted budget. However, explaining how the beginning balance was determined is not disclosed in the budget documents.

- The Aviation Director uses budgeted data rather than actual (CAFR) financial data when reporting financial activity for prior periods. Budgets are a tool to manage current year appropriations or to estimate activity for a future period. Budget data does not accurately reflect actual financial history for prior years. The Financial Summary (depicting five years of revenue history) provided to the Real Estate Task Force was not based on CAFR data, but was based on prior year budgeted revenues and expenditures.

We recommend:

- The Chief Financial Officer disclose in future budgets how beginning fund balances are computed and that data reported as actual for prior fiscal years be based on the prior years' audited financial data.

- The Director of Aviation use audited financial data when reporting financial activity for prior fiscal years.

Management's Response:

- **Agree**
  In 1999, the format of the budget document was upgraded to achieve standards published by the Government Finance Officers Association

(GFOA). One of the upgrades is the inclusion of fund balance information in the budget document. Unfortunately, presenting fund balance information with budgeted expense and revenue information presented a challenge. The numbers are recorded on different bases and don't mix well. For example, budget information is cash based.

GFOA did not provide any direction on the presentation requirements. Additionally, during the last six years since we have been using this presentation, GFOA has not questioned the presentation information and has presented the City of Dallas with the GFOA Distinguished Budget Presentation award. However, the Chief Financial Officer will review the report format and ensure the beginning fund balances are computed and the data reported as actual for prior fiscal years is based on prior years' audited financial data.

- **Agree**
  The Aviation Department is already doing this. During their presentation the City Council's Transportation and Environment Committee on January 9, 2006, the Aviation Department did present financial information both on a budget basis and CAFR information on pages 4 and 5.

  However, financial information presented to make management decisions should always meet the decision makers' needs so we will continue to present budget information. The Aviation Department and the Office of Financial Services recognize the need to present information to the user that is useful. While CAFR information carries with it the benefit that the numbers have been audited and they meet GAAP requirements, these numbers may not be the numbers the City Council needs to use to make decisions. Any Management Accounting course will advise the use of financial data that is usable, friendly and understandable for internal communications. Requiring the use of audited financial data for all historical financial reporting to the City Council may not always be the best use of the information. For example, there would be no way to compare actual results to the budget each year. As stated previously, the numbers are recorded on a different basis.

4. Loan from the Aviation Department is still outstanding and has not been approved by the City Council.

We reported in our May 2005, Audit Report on 9-1-1 Emergency Services that proper procedures were not followed in the $2.3 million "loan" from the Aviation Construction Fund. The loan to 9-1-1 was scheduled to be paid in full by September 30, 2005. $1.5 million remains outstanding as of September 30, 2005.

We recommend the Director of Aviation:

- Seek ratification of the loan from the City Council;

- Disclose and communicate the purpose of the loan and loan payment arrangements to the City Council; and
- Ensure repayment of the loan.

Management's Response:

- **Agree**
  Even though this item was briefed to a City Council committee and management received their concurrence, an item will be added to the City Council's agenda to seek ratification of this loan. The loan is a three year loan and two of the annual payments have been made toward fully reimbursing the Aviation Fund. The repayment plan was further disclosed on page E-1 of the FY 2004-05 Budget Document.

- **Agree**
  Even though this item was briefed to a City Council committee and management received concurrence, we will, as a part of the item added to the City Council's agenda seeking ratification of the loan, include the purpose of the loan and the loan payment arrangements.

- **Agree**
  Management had and still has every intention of repaying this loan to the Aviation fund within three years. This is evidenced by the first payment made during FY 2004-2005 and the second payment made this fiscal year.

5. There are no policies and procedures for the funding and use of reserve/contingency fund.

The Aviation Department has an Emergency Reserve Fund that was established in approximately 1994. However, the department does not have policies and procedures governing:

- How to support and contribute to the fund; or
- Criteria and conditions for using the fund.

Internet research of the nation's medium-sized airports' financial statements shows that most of them have some kind of reserve funds for contingencies and emergencies. The purpose of these funds is to earmark money for emergencies or other unanticipated expenditures that may occur within a given fiscal year.

Reserve funds can be critical to an airport's long term financial viability for the following reasons:

- The existence of adequate reserve funds can provide a buffer or "safety net" against negative financial developments.

- The airport is in a period of prolonged financial restraint that has been created by successive years of downturn in operating results. As a result, the strategy of contributing to reserve funds is one of the few reliable ways to ensure that future requirements for services will be met or that additional negative developments will not curtail the airport's ability to deliver services needed by the airport patrons.

- Reserve funds are used as a financial yardstick to determine an airport's credit worthiness and credit rating. A strong bond rating position allows flexibility to the airport in capital financing and becomes a part of a positive cycle. A strong reserve fund position contributes to a stronger credit position, which in turn allows the airport to issue long-term debt at lower cost. Stronger reserve balances mean that there will be less reliance on long-term debt funding for future projects.

We recommend the Director of Aviation develop policy and procedures that address the funding and use of reserve/contingency funds.

Management's Response:

Agree
The Aviation Fund currently has two reserve/contingency policies and practices funds. One is the 30 day operating reserve. This is consistent with the City Council's Financial Management Performance Criteria. In addition, Aviation maintains a $5M emergency/contingency reserve fund. However, we agree we may need to formalize our current practice. Aviation will conduct a survey of other airports around the country to develop a policy to address the funding level and use of reserve/contingency funds. The new policy will be presented to the City Council and suggested to be added to the Financial Management Performance Criteria currently in use by the City of Dallas.

Section II – Follow-up on Audit of Aviation Lease and Rental Agreements, Report dated January 2005

The original audit report of January 14, 2005, contained three findings with five recommendations. Management implemented one of the recommendations, partially implemented three, and did not implement one.

1. Month-to month leases are allowed to be indefinite in length of term and are not standardized.

We recommended that the Director of Aviation:

OPPORTUNITIES FOR IMPROVEMENT

A. Limit month-to-month leases to no more than 12 months. Current month-to-month leases should be converted to longer term leases (e.g., two to five years). If a business case can be made to support an extended month-to-month agreement, it should be presented to the City Council (at least to the Business and Commerce Committee). Additionally, the Director should seek clarification from the City Attorney (CA) as to what authority the department has to approve and modify a lease without City Manager, City Council, or CA approval. **(Partially implemented)**

We found that Aviation has begun to send notices to month-to-month lessees (approved by the City Attorney) giving them 30 days to enter into a new lease. The thirteen notices we reviewed did not offer a long-term lease; they are all new month-to-month leases for one year, renewable with the opportunity to adjust the rate at renewal.

In a March 2005, briefing to the Business and Commerce Committee, the Director promised to brief to the Committee annually on month-to-month leases in place for more than a year. This has not been reported in 2006. The Director also has sought and received guidance from the City Attorney as to his authority in leasing matters.

B. Coordinate with the CA and develop a standardized month-to-month lease and also consult with the CA to standardize the assessment of penalties and delinquent fees. **(Implemented)**

We found that Aviation has coordinated with the CA and developed a standardized month-to-month lease including assessment of penalties and delinquent fees.

Management's Response:

A. **Agree**
Per the City Auditor's recommendation in the January 14, 2005 Audit report, Aviation briefed the Business and Commerce Committee March 7, 2005 on the status of the department's month-to-month leases. The total number of month-to-month leases at Love Field has been reduced from 31 to 26; a 16% reduction to date from the original audit period. The number of month-to-month leases at Dallas Executive Airport has been reduced from 7 to 3; a 57% reduction from the original audit period. By the authority of City Code, Section 5-3 (c), the Aviation Director may execute month-to-month leases, however, he/she may not approve and/or modify a long-term lease without City Manager, City Council and City Attorney approval. This is the current operating policy for the department relating to month-to-month leases. For any remaining month-to-month leases, the department has a business case

to retain these leases beyond the 12 month period as specified in the audit recommendation.

The 2006 annual report on month-to-month leases will be briefed to the Council's Finance, Audit, and Accountability Committee in August 2006.

B. **Agree**
The recommendation has been implemented.

2. The Aviation Department's property records do not account for all leasehold improvements.

We recommended that the Director of Aviation track and account for all leasehold improvements. **(Not implemented)**

We found that Aviation defined "improvements" in its property management policies and procedures as alterations/additions costing more than $25,000, and these must be approved by the Director. However, AVI relies on the lessees to notify them of any improvements and there is no periodic inspection by AVI personnel to ensure compliance. A prudent landlord should conduct periodic inspections to protect its assets.

Management's Response:

Agree
The Department's standard lease has been modified in accordance with the January 14, 2005 Auditor recommendation to track and account for all leasehold improvements.

All of the current leases require the tenant to report, document and verify capital improvements that are required per the lease. In the event a lessee elects to expend additional sum(s) exceeding $25,000 in any one single event during the lease term, the lessee shall request Aviation Department approval and provide appropriate certificates of expenditures and as-built drawings. Aviation property management staff conducts on-site inspections monthly to monitor the type and extent of any construction on leasehold premises in accordance with contractual obligations and non contractual expenditures.

3. Rental rates should be set to sustain airport operations.

We recommended that the Director of Aviation:

- Should strive to make the airport self-sustaining by developing rates and fees based on market conditions and based on its financial position and obligations. **(Partially implemented).**

OPPORTUNITIES FOR IMPROVEMENT

The Director proposed and City Council approved a landing fee increase to be effective April 2006. However, this increase is merely the reinstatement of a previous fee that was once in effect for larger, noisier jets. AVI has not proposed raising any other fees. Of the 13 month-to-month lease renewal notices sent out recently, only four propose a rent increase.

- Disclose its rates and fees to the City Council, at least annually. **(Partially Implemented)**

We found that the Chair of the Council's Transportation and Environment Committee (at its January 9, 2006, meeting) asked the Department Director to brief the committee annually on Aviation's revenue structure.

Management's Response:

Agee. Partially Implemented
The Aviation Department has established its rates and fees to assure the airport is self-sustaining and remains a financially viable operation. A review of the rates and fees is performed annually during the budget process with very special attention taken to assure these are correct. However, an independent comprehensive review of the current rates and charges is necessary to ensure the staff is following the correct methodology and to have results that will be comparable with other index airports. Management believes this is best suited for an outside consultant specializing in the full scope of airport rates and charges analyses. The most recent rates, fees, and rental charges study conducted for Dallas Love Field and Dallas Executive Airports by an independent consultant was conducted by Deloitte Haskins-Sells in January 1986. We agree it is time for a new third party review.

Section III – Follow-up on Real Estate Task Force Recommendations Report dated October 2004

The Real Estate Task Force recommendation relating to the development of a policy to ensure annual reporting to the Council on month-to-month leases has not been implemented. All remaining 38 recommendations have been implemented.

EXHIBIT 1

Summary of Adopted Annual Budgets

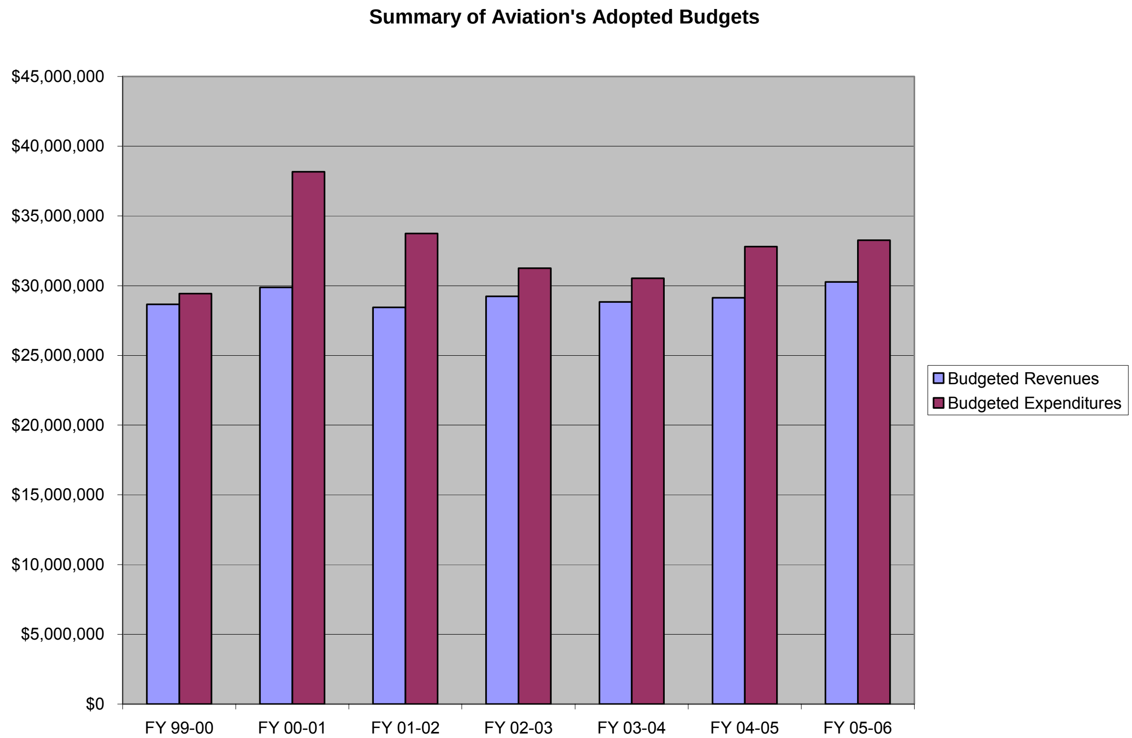
	FY 99-00	FY 00-01	FY 01-02	FY 02-03	FY 03-04	FY 04-05	FY 05-06
Budgeted Revenues	$28,663,254	$29,876,012	$28,445,096	$29,228,272	$28,842,431	$29,127,542	$30,263,240
Budgeted Expenditures	$29,436,800	$38,165,859	$33,742,273	$31,247,661	$30,531,664	$32,805,702	$33,264,385
Excess Revenues (Deficit)	($773,546)	($8,289,847)	($5,297,177)	($2,019,389)	($1,689,233)	($3,678,160)	($3,001,145)

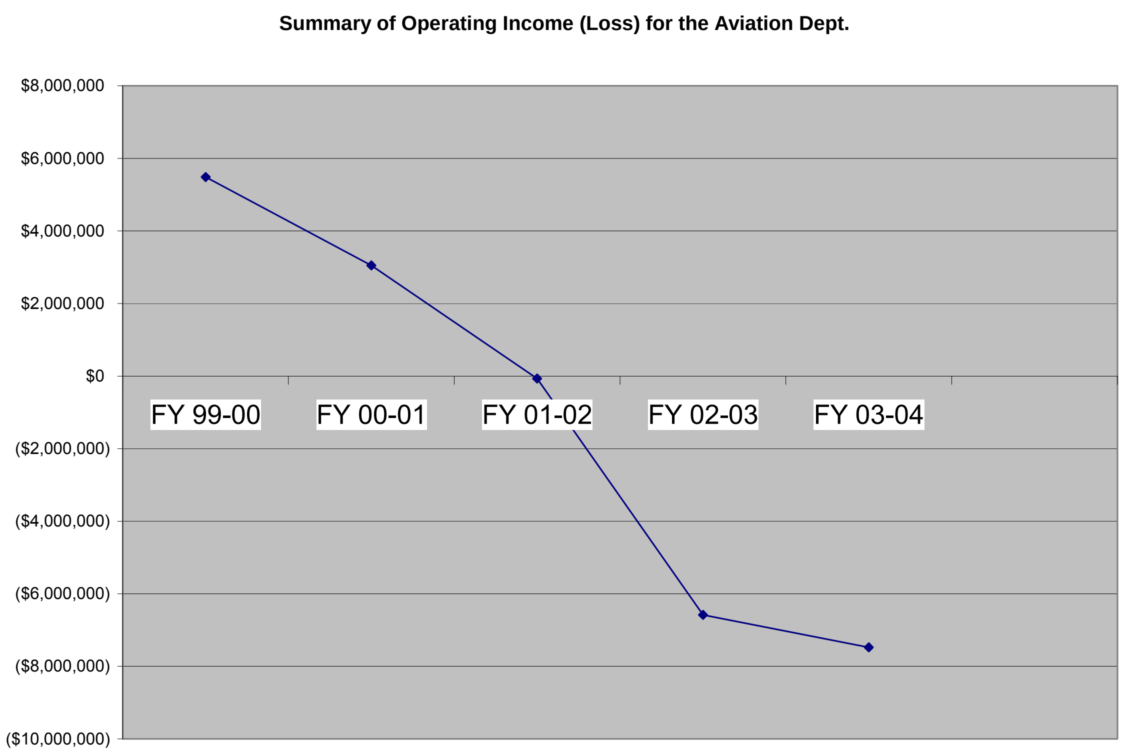
Summary of Operating Income (Loss)

Airport Revenue Fund
Statement of Revenues, Expenses & Change in Net Assets
FY 2000-2004
(In thousands)

	FY 00	FY 01	FY 02	FY 03	FY 04
Prior year net assets	261,746	291,782	321,697	321,683	321,137
Operating revenues	29,252	29,789	30,264	25,753	31,601
Operating expenses before depreciation	16,861	19,661	23,300	21,690	27,528
Operating Income before depreciation	12,391	10,128	6,964	4,063	4,073
Depreciation	6,903	7,075	7,034	10,644	11,547
Operating Income (Loss)	5,488	3,053	(70)	(6,581)	(7,474)
Net non operating revenues/expenses	4,543	11,069	719	(5,191)	(1,278)
Income before transfers & contributions	10,031	14,122	649	(11,772)	(8,752)
Transfers in					
Transfers out	(634)	(642)	(663)	(521)	(46)
Contributions	20,639			11,747	59,544
Change in net assets	30,036	13,480	(14)	(546)	50,746
Prior Period Adjustment		16,435			
End of year net assets	291,782	321,697	321,683	321,137	371,883

EXHIBIT 2


Summary of Aviation's Adopted Budgets
$45,000,000
$40,000,000
$35,000,000
$30,000,000
$25,000,000
$20,000,000
$15,000,000
$10,000,000
$5,000,000
$0
FY 99-00
FY 00-01
FY 01-02
FY 02-03
FY 03-04
FY 04-05
FY 05-06
Budgeted Revenues
Budgeted Expenditures


Summary of Operating Income (Loss) for the Aviation Dept.
$8,000,000
$6,000,000
$4,000,000
$2,000,000
$0
($2,000,000)
($4,000,000)
($6,000,000)
($8,000,000)
($10,000,000)
FY 99-00
FY 00-01
FY 01-02
FY 02-03
FY 03-04